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Tax Features

Presidential Visit Highlights 43rd Annual Conference

President Ronald Reagan dropped in unannounced at the Tax Foundation's 43rd annual conference in New York City on November 20. Tax Foundation Co-Chairman James

President Ronald Reagan made a surprise appearance at the Tax Foundation's annual conference. He urged the crowd, especially the many young people in attendance, to participate in our democratic system, to "twist the arms" of our elected representatives when they don't respond to the wishes of the people.

C. Miller III, President Reagan's Director of the Office of Management and Budget, introduced "the man who has had the most impact on tax policy in the past several decades, my former boss, the 40th President of the United States, Ronald Reagan."

The audience of 225, including 100 students in attendance as part of the Tax Foundation's College Classroom Project, kept up sustained applause, but the President eventually quieted them and warmed to the subject of taxes. "When we had our big tax cut in the beginning of my first administration, revenues jumped and the economy jumped. For the next eight years, this country had the biggest economic increase in its history."

Part of his plea for lower rates was an endorsement of President Bush's proposal to lower the capital gains tax rate. President Reagan urged the assembly to dismiss congressional fears that the government would collect less

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FRONT BURNER

Long-Term Growth Should Be Tax Policy's Top Priority

Sen. Robert Kasten

The U.S. economy is stalled. The result of massive tax hikes and increased regulation, the recession has cost over 1.5 million Americans their jobs. Implementing an economic recovery package that will get the economy moving again should be the top priority of Congress and the Administration.

An economic recovery package should do more than provide a temporary stimulus to the economy. It should also put into place tax policies that will sustain long-term economic growth. I have joined with Representative Vin Weber of Minnesota in introducing the "Economic Growth and Family Tax Freedom Act of 1991" (S. 1920, H.R. 3744). This package offers the best plan to revive the stalled economy, sustain long term growth, and reduce the heavy tax burden on middle class families.

America's prosperity is threatened by slow economic growth. Our post World War II growth path is 3 percent real growth in GNP per year. When we fall below that, it means lost jobs, lost output and lost family income. The economy has been growing at well below that level for the last two years, and even if the economy turns around and grows at the Office of Management and Budget's projected 2.5 percent per year, it will mean 9 million fewer jobs by 1996, relative to the normal post-war growth path. Clearly, this "growth gap" must be eliminated.

The Kasten-Weber proposal is designed to eliminate the growth gap with a six point plan that includes tax credits for working families with children, a reduction in the capital gains tax, a speed-up of depreciation for business

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Senator Robert W. Kasten, Wisconsin Republican, is Chairman of the Senate GOP Task Force on Economic Growth and Job Creation.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Tax Foundation

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equipment and machinery, expanded IRAs, reform in the tax treatment of real estate, and enterprise zones.

Our proposal reduces the heavy tax burden on families by providing a $300 tax credit for each child age 6-18, and a $1,000 tax credit for each child under age 6. This credit is available only for working families, and can be used only to the extent of income tax and payroll tax liability.

Even if the economy turns around and grows at OMB's projected 2.5 percent per year, it will mean 9 million fewer jobs by 1996, relative to the normal post war growth path.

The middle-class family has been squeezed particularly hard by the increasing burden of taxes. The Tax Foundation reports that the typical taxpayer now works until May 8 of each year just to make enough to pay its total tax bill. The declining value of the dependent exemption is largely responsible for the heavy tax burden on families. If the dependent exemption shielded from taxation the same proportion of annual income in 1991 as it did in 1948, a family today would be able to exempt nearly $8,000 per child instead of the current $2,150. Our tax credit is designed to address this dramatic decline in the value of the dependent exemption.

Our proposal also slashes the capital gains tax from 28 percent to 15 percent (7.5 percent for those in the lower tax bracket). This is coupled with indexing to protect savers and investors from inflationary gains. Most other growth packages introduced in Congress either contain no capital gains tax cut or watered-down versions of the proposal that will do little to stimulate the level of investment necessary to create new ventures and new jobs. By contrast, economist Allen Sinai estimates that a 15 percent rate will create up to 2.5 million new jobs over 5 years. It will also bring the U.S. into line with the other leading capitalist economies, many of which have no tax at all on capital gains.

Moreover, this proposal reforms the current system of tax depreciation. In order for American industry to remain competitive, the tax treatment of equipment and machinery purchases needs improvement. When machinery is purchased, its cost cannot be written off immediately, but must be deducted over a number of years. The value of this deduction is eroded by inflation and the time value of money. Our proposal addresses this erosion by indexing depreciation schedules so that the value of each year's deduction keeps pace with inflation.

In addition, our package eliminates the disincentive for capital investment that results from the Alternative Minimum Tax (AMT) treatment of depreciation. Presently, any depreciation in excess of straight line depreciation is included as an adjustment under the AMT. This actually punishes capital intensive companies. At a time when our international competitors are doing everything possible to encourage capital investment, the U.S. is doing the opposite. We eliminate this disastrous policy by completely phasing out the corporate AMT depreciation adjustment by the year 2000.

One of the major reasons the economy is performing poorly is the depressed value of real estate. The Tax Reform Act of 1986 contributed to this decline in values by increasing the capital gains tax and imposing unfair passive loss restrictions on real estate. Investment in rental real estate was singled out during Tax Reform and defined as "passive" investment regardless of whether a taxpayer materially participates in the activity. Generally, no losses from this passive activity can be used to offset other income.

Our legislation changes this by providing equality in treatment under the passive loss rules. That is, the taxpayer would be allowed to establish that he or she materially participates in the rental activity. If so, losses from the rental real estate activity would be deductible without restriction. By increasing the value of real estate, this reform will have the beneficial side effect of reducing the cost of the S&L bailout.

The Kasten-Weber package encourages long-term saving by establishing IRA-Plus accounts. This will permit individuals to make non-deductible contributions to IRAs where the interest accumulates and compounds; then it is distributed tax free. The proposal allows for the use of up to 25 percent of the account for education, the down payment on first-time home purchases, and certain medical expenses.

Finally, the legislation creates enterprise zones which target business investment and job creation in economically depressed urban and rural areas. Enterprise zones offer special tax incentives to companies that locate and create jobs in economically depressed areas. The zone tax incentives include an employee tax credit, elimination of the capital gains tax on zone investments and real property, and stock expensing. Enterprise zones have been successfully implemented in dozens of states. The addition of federal tax incentives would provide a major boost to these programs.

How will we pay for these tax incentives? The big reason for today's record budget deficit is the decline in tax revenues due to recession. Get the economy moving again with growth incentives, and tax revenues will rise. Using the Congressional Budget Office's "rules of thumb," if our tax cut plan raises the rate of growth just one percentage point per year over today's forecast, the cumulative deficit reduction would add up to $258 billion by 1996 — more than enough to finance the static cost of these tax cuts. Adding Sen. Lloyd Bentsen's $70 billion "peace dividend" from a lower U.S. defense profile would put the budget deficit on a permanent downward glidepath.

An economic recovery package . . . should also put into place tax policies that will sustain long-term economic growth.

Many "growth" packages have been introduced in Congress in the last several months. Unfortunately, few of these provide for the type of comprehensive tax reform that is necessary to sustain long-term economic growth. Several tax plans are not tax cuts at all, but merely offset tax credits with higher tax brackets. These plans attempt to redistribute wealth, not create it. Others simply do not contain enough tax reduction to make a significant difference to the average taxpayer. The Kasten-Weber proposal provides both substantial tax relief and dramatic growth incentives that are necessary to rebuild the economy. ■

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revenue. "You are going to have an increase in economic growth and an increase in revenues."

Despite criticizing Congress for being "dead-set against things that would reduce the burden of taxation," President Reagan put part of the blame on citizens who don't participate in government. " 'We The People' is what our whole Constitution is about," he said, adding, "Each of us has a responsibility to let those representatives of ours in government know when we think they are doing things that are detrimental to the society and to our way of life."

Tax Fairness — Reality and Rhetoric

Though unplanned, the appearance by President Reagan dovetailed nicely with the first theme of the conference, "tax fairness." It was during his first term that he signed into law the most dramatic tax cut in the last 25 years, the Economic Recovery Tax Act of 1981. Then during his second term, the Tax Reform Act of 1986 became law, thoroughly revamping the tax code and drastically reducing marginal tax rates. These two pieces of legislation are the hallmarks of the Reagan era's tax legislative legacy and are common reference points in current discussions of whether tax policy is "unfair."

President Ronald Reagan enjoys a laugh with his former OMB Director, James C. Miller III, who is now co-chairman of the Tax Foundation.

Moderator Floyd Williams, chief tax counsel for the Tax Foundation, laid the groundwork for the debate, pointing out that the total tax burden as a percentage of national income is higher than ever, 35.1 percent, and that since 1980, the

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Foundation Shows Impact of New Tax-Relief Proposals on Typical American Family

The prolonged economic slowdown has prompted federal legislators to propose numerous tax-relief and economic growth measures. In response, the Foundation has produced a summary of the major proposals, titled *Fiscal Policy Update. Summary of Major Federal Tax Relief and Economic Growth Proposals*, which has been well received on Capitol Hill and in the media.

The report includes a summary matrix and brief discussion of each proposal's tax-relief and economic growth provisions, as well as its potential revenue impact. The table below provides a snapshot of how the bills would affect two typical American families in the first year after enactment. ■

1991 Major Federal Tax Relief Proposals

Example of Family Impact (a)

Proposal	Family Income	Income Tax	Social Security Tax	Total Tax	Net Savings
Current	$53,265 (b)	$6,493	$4,075	$10,568	-
Law	$30,000 (c)	$2,359	$2,295	$4,654	-
Bentsen	53,265	5,333	4,075	9,408	1,160
	30,000	1,459	2,295	3,754	900
Bradley	53,265	5,793	4,075	9,868	700
	30,000	1,659	2,295	3,954	700
Coats/Grassley/Wolf	53,265	5,397	4,075	9,472	1,096
	30,000	1,454	2,295	3,749	905
Dreier	53,265	5,346	4,075	9,421	1,147
	30,000	1,850	2,295	4,145	509
Gore/Downey	53,265	6,097	4,075	10,172	396
	30,000	1,404	2,295	3,699	955
Gramm/Gingrich	53,265	6,493	4,075	10,568	(d)
	30,000	2,359	2,295	4,654	(d)
Kasten/Weber	53,265	5,193	4,075	9,268	1,300
	30,000	1,059	2,295	3,354	1,300
Moynihan (e)	53,265	6,493	3,808	10,301	267
	30,000	2,359	2,145	4,504	150
Packwood	53,265	5,844	4,075	9,919	649
	30,000	2,123	2,295	4,418	236
Rostenkowski	53,265	6,093	4,075	10,168	400
	30,000	1,959	2,295	4,254	400
Roth	53,265	4,821	4,075	8,896	1,672
	30,000	1,644	2,295	3,939	715
Schulze	53,265	5,737	3,542	9,279	1,289
	30,000	1,954	1,995	3,949	705
Walker (f)	53,265	4,868	4,075	8,943	1,625
	30,000	1,766	2,295	4,061	593
Wallop/DeLay	53,265	6,493	3,595	10,088	480
	30,000	2,359	2,025	4,384	270

(a) First-year impact of direct changes in the personal income tax, employee Social Security tax, personal exemption, personal tax credits, and deductible IRA investments. (Excludes capital gains tax changes.)
(b) Estimated median family with two full-time workers. File joint return; two dependent children ages 4 and 7. Family invests $2,000 in new deductible IRA account.
(c) Estimated two-earner income for married couple household. File joint return; two dependent children ages 4 and 7. Family invests $2,000 in new deductible IRA account.
(d) Plan allows tax-free withdrawal of IRA and $1,000 tax credit for first time home-buyer not examined in this example.
(e) Additional future reductions in the payroll tax rate are scheduled.
(f) Also allows $1,000 tax credit for first time home-buyer not examined in this example.
Source: Tax Foundation.

Senator Max Baucus

Tax Cuts Yes — But For Investment in America

Let's imagine for a moment that in 1980 a Fortune 500 company had planned to reduce spending on new plant and equipment by 50 percent, postpone half of its research and development projects, cancel employee training programs, cut the employee health program, and defer maintenance on company buildings.

Where do you think that company would be today, 11 years later? Yet since 1980, the share of the nation's economy devoted to investments, education and training, children's programs, infrastructure and civilian R&D has dropped 40 percent. Our country can't continue down that road any more than a company could and expect to remain in business.

It is a time of uncertainty — the economy is flat, or it is falling. We just witnessed the credit card interest rate cap on and off again. Wall Street and Washington are blaming each other. Corporate America is very critical of the Congress and of the President. The voters are blaming everyone, and the President seems curiously disengaged.

This turmoil is illustrated by the current tax policy debate. Until recently, the 102nd Congress was expected to be very quiet in terms of tax policy. We were going to reauthorize expiring provisions and perhaps simplify some complex parts of the Code, but that was about it. Lobbyists were wondering how they were going to meet their expenses.

Suddenly, everything has changed. In the past few weeks, we have seen the tax scene explode with debate over various tax proposals. They are popping up like wind-swept wildfires: tax cuts for the middle class, all kinds of them; capital gains; IRAs; combinations of all three cutting in different economic and ideological directions.

Clearly, we need to take some short-term measures to restore economic growth, and tax cuts designed to accomplish this should be concentrated on middle-class working families. But there is real danger that competition for political advantage, especially in an election year, could yield a result that merely sows the seeds of greater problems down the road. Lurching through a series of short-term measures cannot substitute for a strategic vision to improve our economic competitiveness.

We can begin by taking advantage of the blossoming democracies and the free enterprises in Europe and the Soviet Union. We have achieved a true victory in the cold war, and with this victory comes a reward. Some call it a peace dividend. I think a better term would be an investment-in-America dividend.

How can we use it to our advantage? Let me suggest three priorities: deficit reduction, investment in America's future, and rewarding those who fought and won the cold war.

Our massive debt has done such damage to the economy that the first claim on any dividend must be deficit reduction. The growing mountain of debt has sapped savings and investment. We could do much to alleviate this, but without the President's help, the best we are likely to achieve is piecemeal progress. Nevertheless, something is better than nothing.

Second, a portion of this dividend should be used to prepare us for the next round of competition, the international economic struggle. We need to focus on investments that will increase our competitive edge. But remember, the words 'investment' and 'tax incentive' are not synonymous. Just because something reduces corporate taxes does not necessarily make it good tax policy.

There certainly are appropriate tax incentives. A permanent R&D tax credit is long overdue; IRAs to increase our long-term savings rate; and yes, a capital gains incentive to encourage investments in new and innovative companies. We must recognize that investment is not just tax credits — it involves some spending programs too, such as education and job training. Our children must be better prepared for their first job, and current workers need the security that comes with the wherewithal to adapt to changing employment opportunities and needs.

It means making investments in infrastructure — roads, bridges, mass transit, airports, enhanced communications networks — they are the foundation of an independent manufacturing base and a strong economy.

It means more direct investment in research and development, especially civilian R&D where both Germany and Japan outspend us. It means making our financial environment hospitable to long-term investment, and encouraging savings so that we can obtain funds for investment from domestic as well as foreign sources. And it means fixing our health care crisis, which is causing American business to suffer a terrific competitive disadvantage.

Our massive debt has done such damage to the economy that the first claim on any dividend must be deficit reduction. The growing mountain of debt has sapped savings and investment.

As with tax credits, not all spending programs are of equal ment. Our resources are limited, and we must focus on those that are most effective in encouraging long-term investment.

The final part of this dividend should go to the real heroes of the cold war — the American family — for their years of hard work, patience, and perseverance. Several proposals in Congress would provide such a reward, most targeted to the middle class. It is clear that a tax relief bill will be the centerpiece of the legislative agenda for both parties next year. I support this effort, but we must realize that we are not in a purely cyclical recession. We are reaping the bitter fruit of a decade of high deficits and underinvestment. We won't cure the underlying problem solely with traditional fiscal medicine. So whatever tax relief is proposed or enacted, it should be consistent with our long-term competitiveness strategy.

An economic future for America that we all want will not be easy. There are those who will preach quick or painless solutions, or ideological solutions. We must reject them all. It will take patience, courage, and leadership. But, we must meet the challenge because it is right — right for our country, right for ourselves, and right for our children.

Senator Max Baucus, Democrat from Montana, is a member of the Senate Finance Committee and Chairman of its Subcommittee on International Trade. This column is digested from the speech he gave November 20, 1991, after receiving the Foundation's annual Distinguished Service Award for the Public Sector.

Paul O'Neill
Chairman & CEO
Alcoa

Fiscal Policies for the New World Order Demand Drastic Tax Code Revision

Let me tell you about a new circumstance that has affected our company, our industry, and our country in the last couple of years — a circumstance which is frankly quite a surprise to me. Remember that two years ago, the Berlin Wall came down. That was a critical turning point in the lifetime of our generation, and it gave me a sense of exhilaration.

Today, such a short time later, we are seeing the political and economic dissolution of the Soviet Union. Frankly, it hadn't occurred to me that the consequences of that dissolution would be found so quickly and importantly in our own company. You might wonder how that could possibly be — let me teach you a little bit about our industry.

In the western world, there are about 16 million metric tons of annual capacity to produce aluminum, and for a very long time, I suppose, there have been 4 million metric tons of capacity in the Soviet Union. But until two years ago, the 4 million tons of capacity in the Soviet Union might as well have been in the moon because it was of no consequence to the west. It was consumed by the Soviet defense economy and by the private economy to the degree that it was used in their consumer goods.

With the dissolution of their political system, they have begun sending enormous quantities of aluminum material into the west. Most businesses have not seen this yet, but in our business, it has had such a significant effect that today, world prices for primary aluminum are 50 percent of what they were two years ago. In fact, they are lower than they have ever been.

I relate this story from our industry to a tax audience because it makes the point that the world is not only getting smaller all the time — it has gotten smaller in an important way, in a big hurry, and quite by surprise. I submit to you that until recently, we in the U.S. have been able to ignore most of the world, and frankly, I think our tax system is a testament to a worn out idea: that we live in an island economy and that our tax system need only be rationalized internally. This is no longer true.

I will tell you from traveling the world, international competition is coming with a vengeance. And I don't believe we can any longer afford to have a tax system that is, in effect, a conglomeration of special interest legislation. At least for myself, I would be happy to do without R&D credits and any other kind of credits if I could have in place of the current tax system, one that was very simple to calculate, that was on gross sales or some other easy to measure indicator of economic activity. We must face that prospect and stop acting as though it were good enough to touch up the edges of our system.

Having been in Washington for 15 years, ten of them at OMB, I thought when I was first asked if I would accept this award that it must be for my public sector service because I was present in fiscal year 1969 when this nation ran its last federal surplus. In fact, when I left in 1977, the budget problem was still solvable. I am not so sure it is anymore, without radical change.

That is why I urge that it is time for us to think of an ideal tax system that is not so driven by special political interests, one where we are trying to gain narrow marginal advantages against each other. We must open our eyes to the world and realize that the world we are going to leave for those who follow us in the United States is going to be a pale shadow of what was turned over to us by our parents.

More specifically, in the area of tax administration, join me in being appalled by the roughly $50 billion we incur to administer the federal tax system in the corporate sector. When I add the cost of administering taxes to my products, I have not added any value from the customer's point of view. Whether the customers are in Brazil or Rumania or Taiwan, they are not particularly interested in a political process that by our own hand adds cost without value.

Let me say again, the administrative cost of our tax system is a net negative. There is nothing positive about it — the most brilliant minds in my corporation are required to be in tax jobs because the system we have is such an abomination. But without that brilliance, our corporation would be at risk compared to the competition. It is a terrible misuse of human capital.

International competition is coming with a vengeance. And I don't believe we can any longer afford to have a tax system that is, in effect, a conglomeration of special interest legislation. At least for myself, I would be happy to do without R&D credits and any other kind of credits if I could have in place of the current tax system, one that was very simple to calculate, that was on gross sales or some other easy-to-measure indicator of economic activity. We must face that prospect and stop acting as though it were good enough to touch up the edges of our system.

Now, with all of that, you might understand why it is when I read about tax simplification and the concepts that are being discussed are so arcane, I can't even figure out which subparagraph is going to be modified, that it doesn't measure up to my idea of tax simplification.

I frankly think we need to tell ourselves, and we need our political leaders to tell us, that the time for games is over. We must stop saying that business must pay its fair share because we all know that's a cruel joke on the American people. Business does not, in fact, pay the taxes — taxing business is just a way to confuse people. At the end of the day, we as individuals pay whatever taxes are paid.

I would submit to you that until we have the political maturity to face these facts, we are going to continue on the slide we are on, and as for me, I am going to do everything I can within my company to make sure we are not a part of it.

Paul O'Neill, Chairman and Chief Executive Officer of Alcoa, received the Foundation's 1991 Distinguished Service Award for the Private Sector. This column is digested from his acceptance speech.

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typical family tax burden has risen approximately 60 percent.

Moving up the income scale, Williams made a point heard less often. "Wealthier taxpayers usually play the villain's role in the fairness debate, but IRS income tax data for 1989, the latest year available, show the top 10 percent of income earners in this country paid about 55 percent of the total tax burden."

He then introduced the four panelists who addressed this increasingly hot political question: Bruce Bartlett, Deputy Assistant Secretary for Policy Analysis, Department of the Treasury; Wendell Primus, Chief Economist, House Committee on Ways and Means; Norman B. Ture, President, Institute for Research on the Economics of Taxation; and Paul W. McCracken, Edmund Ezra Day Professor of Business Administration, University of Michigan.

Bruce Bartlett shed light on basic income distribution data, published by the Census Bureau, which divides the nation's households into five 20-percent income brackets, or quintiles, and Bartlett's analysis of 1982 and 1989 showed all quintiles with higher real incomes in 1989. Acknowledging that the highest quintile's income rose the most, 21.6 percent, he pointed out that the lowest quintile's gain, 13.6 percent, was also substantial.

Bartlett asserted that mobility among the Census quintiles is substantial and quoted a University of Michigan study which found that between 1971 and 1978, half of all people in the highest and lowest quintiles shifted up or down.

He cautioned against data based on cash income only. This excludes the effects of the tax system and the in-kind benefits paid out to people, such as government housing subsidies and food stamps. He warned, "The danger is that people rightly become frustrated. They say, 'We are spending billions and billions of dollars a year to help the poor and raising taxes on the rich, yet the income distribution gets more unequal. Why is that?' It is because we have excluded all these things we are doing from the calculation."

Wendell Primus also shed light on the income distribution data used in the fairness debate, but the light was shining from a different direction. "My preferred measure is to take family cash income and divide by a family size adjuster . . . implicit in the poverty thresholds. This expresses income as a multiple of the poverty line." With this method, Primus sees a four percent income loss from 1973 to 1989 for the average member of a family in the lowest quintile and an average gain in the top quintile of 28–29 percent. He observed that the elderly in all quintiles had fared very well while families with children have slipped badly, leading to numerous tax cut proposals aimed at families with children.

Norman Ture addressed the most basic issue of tax fairness — the question of whether progressive taxes are indeed fair from a moral and ethical perspective. "The conventional view of fairness is that income inequality itself is unfair." Ture asserted that equal status before the law was the only true criterion for fairness and that those people in society who are poor for whatever reason, be they young and unskilled, physically or mentally unable to work, or simply unwilling to undertake activities that others will pay for, are not poor because the rich have extracted wealth from them, so no legal remedy is called for.

"A progressive tax system is by its very nature as unfair as it can be against this criteria of fairness," Ture said. "In effect, the greater your capacity, the greater the effort you put into work from which others benefit, the more productive you are, the higher your income is, the lower your status before the law."

Sidney Jones, Assistant Secretary of the Treasury for Economic Policy, fields questions from two financial reporters after his presentation.

Paul McCracken called for more theoretical work on what distribution of income is most beneficial to the economy. Much greater study is needed on the incidence of taxes, corporate taxes for example, and on the distribution of the benefits of government spending — not just transfer payments, but all government spending.

Commenting that by American standards, economic growth has been very slow in the last couple decades, McCracken pointed out, "One of the basic problems is that government has been growing too fast in any case, putting pressure on the revenue side as well as the expenditure side. If you look at the last ten years, government expenditures have been equal to 41 percent of the rise in net national product. . . . From 1988 to 1990, total government expenditures were 48 percent of the rise in net national product. That marginal rate is too high, and there is a good deal of analytical evidence that countries with that rate of growth in government spending will show slower rates of economic progress."

America in the World Economy – International Competitiveness

"Tax Policy in a Global Economy: How Well Can the U.S. Compete?" was the theme of the second conference session. It examined the role that tax law plays in the ability of U.S. and foreign-owned multinationals to compete in a global market. Panel moderator William Glasgall, International Economics Editor at *Business Week*, introduced Sidney L. Jones, Assistant Secretary for Economic Policy, Department of the Treasury; Alan Auerbach, Professor of Economics, University of Pennsylvania and consultant to the Joint Committee on Taxation; Ray Haas, International Tax Partner, Ernst & Young; and Lawrence Kudlow, Senior Managing Director and Chief Economist, Bear Stearns & Co.

Sidney Jones said that a primary reason fiscal policy adjustments may be necessary to promote U.S. competitiveness is our long-term decline in economic growth. Another is the new portability of technology which puts a premium on productivity. Of course, many tools for stimulating growth involve tax incentives. "In 1988, 1989, 1990 and 1991 we've asked for growth incentives and tax incentives," Jones said, "[but] while we are much in favor of lower taxes, we must be straightforward with the nation. If we are going to spend 24–25 percent of GNP on federal government outlays, 95 percent of which are consumption, and we are only willing to raise 19 percent in tax revenues, we will run a 4–5 percent deficit to GNP ratio."

Alan Auerbach said the U.S. standard of living has slipped for two de-

cades, and asserted that any discussion of competitiveness should relate to that standard — "not so much to the behavior of any one industry or short-term issues like relative costs home and abroad. . . . [which] tend to be tied up in macro-economic considerations, exchange rates, fluctuations in different economies, and ultimately are much more difficult to deal with using tax policy."

After giving pros and cons for private savings incentives and value-added taxation as ways to increase national savings, Auerbach concluded, "We have to keep our eye on the ball here, and the ball is national savings."

Raymond Haas brought the practitioner's perspective to bear on international competitiveness. He encounters two principal hurdles in his work for U.S.-based multinationals which foreign-based companies do not. U.S.-based firms cannot take advantage of special tax incentives offered by developing nations — the U.S. Treasury simply collects what the foreign nation would have collected without the incentive.

"The U.S. foreign tax credit system, which is supposed to be avoiding worldwide double taxation, actually creates double taxation."

–Raymond Haas

"The second example is . . . that the U.S. foreign tax credit system, which is supposed to be our way of avoiding worldwide double taxation, actually creates double taxation," said Haas, "[and] much more significantly since the Tax Reform Act of 1986."

Haas concluded with a plea for more stability and less complexity in tax law. He cited the R&D tax credit: "For the seventh time in 10 years we are in a period of not knowing what the impact of R&D is going to do to our companies' worldwide tax liability. I just don't think that is productive."

Lawrence Kudlow said most U.S. marginal tax rates compared favorably with those of other major trading nations — except capital gains. "This is a point which is often lost in the debate, particularly, the cumbersome, dreary debate in Washington of late, 'rich versus poor' and the like. . . . We have the highest capital gains tax rate [while] Germany and Japan have rates of zero and five percent respectively. No wonder we are concerned about long-run productivity trends, and no wonder we are concerned about capital formation trends."

Kudlow goes further and declares that the U.S. is poised for a full economic recovery — interest rates are low and inflation is down. "But there is a bone sticking in the throat of the economy, and that bone is the lack of risk taking. . . . Since new companies are the principal creators of jobs, we shouldn't be surprised that we barely created any jobs in the last three years." ■

FOUNDATION MESSAGE

A Wish for the New Year

Floyd Williams
Chief Tax Counsel

The United States could breathe a collective sigh of relief when Congress did, in fact, close shop for the year just prior to the Thanksgiving holiday. Rather than Congress closing the year with a tax increase, as it did in 1990, the tax-writing committees scheduled several days of hearings during the month of December to examine various legislative proposals designed to cut taxes for middle-income taxpayers and to stimulate economic growth. This, presumably, will set the stage for comprehensive tax legislation early next year.

In another act of charity, Congress extended for six months several tax provisions that would have expired at the end of 1991: the tax credit for research and experimentation expenditures, the tax credit for low-income housing construction and rehabilitation, and the targeted jobs tax credit, among others.

While Congress did not increase federal income taxes this year, the news on the tax front was not entirely good for the U.S. taxpayer. That is because many states that find themselves with budgetary problems are choosing to increase taxes rather than reduce spending. For example, thirty states enacted tax increases that will raise a total of $17 billion in new revenue in fiscal year 1992, making fiscal year 1991 the biggest revenue-raising year in history at the state level. This is likely to push this year's Tax Freedom Day of May 8, 1991, to an even later date next year.

More bad news arrived last fall when a Tax Foundation study showed that accelerating taxes will combine with inflation to make the typical American family $362 poorer this year than it was in 1990. This $362 loss is the largest one-year decline in family income since 1981. Notwithstanding two major income tax rate reductions during the 1980s, the typical family's income tax bill has risen by 60 percent over the decade. In 1991, total taxes (federal, state, and local) as a percentage of total income was 35.1 percent, and this figure is likely to increase next year because of higher taxes at the state and local levels.

The point is that Congress should consider the increasing tax burden, at both the federal and state levels, when it considers tax legislation next year to get the economy moving again. Although it is going to be hard to do in an election year, when tax cuts traditionally become a political football, Congress should avoid the temptation to provide a "quick fix," and it should cease engaging in "class warfare," which is to no one's benefit.

If the economy is still faltering when Congress returns in early 1992, with financial institutions failing, real estate depressed in many parts of the country, and the deficit growing due largely to unchecked government spending, the Congressional agenda will be serious indeed. Congress should listen carefully both to what the tax-writing committees discover during their hearings and to what the constituents back home are saying. If after consultation with the American people, Congress and the Administration enact a tax cut, it should be a true tax cut which results in economic growth and job creation, rather than merely a shifting of the tax burden among families. Only through cooperation among the Democrats and Republicans in Congress, as well as the Administration and the people back home, can we expect to arrive at a sound tax and budget policy to restore this country to its pre-eminent position of economic strength as we begin our move into the twenty-first century.

54th Annual Dinner Honors Max Baucus and Paul O'Neill

The Tax Foundation's 54th annual dinner entertained over 300 people at the Waldorf-Astoria in New York City the night of November 20. The evening's honorees were Senator Max Baucus (D-MT) and Paul O'Neill, Chairman & Chief Executive Officer, Alcoa. Each year, the Foundation bestows two Distinguished Service Awards, one for contributions to tax policy in the public sector, and one for the equally critical efforts from citizens in the private sector. (See pages 4 and 5 for digests of Senator Baucus's and Mr. O'Neill's remarks.)

The dinner followed a conference which addressed tax fairness and international competitiveness, and which included a surprise visit by President Ronald Reagan (see page 1). ■

Tax Foundation Co-Chairman James Q. Riordan, (r.), with Richard J. Hiegel (l.), Partner, Cravath, Swaine & Moore, and M. Alanson Johnson II (c.), Executive Vice President, Treasurer & CFO, P.H. Glatfelter Co.

The two recipients of the Foundation's 1991 Distinguished Service Awards, Paul O'Neill (l.) and Senator Max Baucus (c.), pose with Senator Harry F. Byrd, Jr.

W. Bruce Thomas, former Tax Foundation chairman and long-time Policy Council member, retired in October from his position of Vice Chairman - Administration & CFO at USX Corporation. Here Senator Harry F. Byrd, Jr., thanks Bruce for his many years of work for the Foundation.

Left to right at a reception for Senator Baucus and Mr. O'Neill: Dan Witt, Executive Director, Tax Foundation; Charles Corry, Chairman & CEO, USX Corp.; Glenn White, Program Committee Co-Chairman, Tax Foundation; and Paul McCracken, Professor Emeritus of Economics, University of Michigan.

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